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Evidence -- Income Tax Returns -- Admissibility

Walter E. Brock Jr.

Evidence—Income Tax Returns—Admissibility

In *Davis v. Atlantic Coast Line Co.*[1] the plaintiff claimed damages to his property and business due to the negligence of defendant. For purposes of contradicting plaintiff's testimony as to amount of damages, defendant introduced plaintiff's federal income tax return for the period during which plaintiff claimed he was damaged, and it was allowed in evidence over objections.[2]

The purpose of this note is a brief investigation of the propriety and usefulness of income tax returns as evidence, in civil cases, of income, profit, loss, or other matter reported therein.

Anything that a party has said, if relevant, is admissible against him as an admission[3] to be considered by the jury. And the admission by an employee or agent, acting within the scope of his authority, is admissible against the principal.[4] Declarations by a taxpayer on personal property tax lists are admissible against him on the issue of the value of the property; though real property valuations for tax purposes are held not to be admissions, since they are made by an independent third party.[5] It seems logically to follow that a party's declaration in his income tax return as to his income, or any other matter contained therein, would be admissible against him as an admission; and this would follow whether the return is made out by the party himself, or by someone employed by him for that purpose.[6] Such an admission would, of course, not be conclusive, but merely evidence for the consideration of the jury, and may be explained or shown to have been the result of mistake.[7]

When it becomes desirable for purposes of impeachment to show that an opponent's income is less than claimed in his testimony, his income tax return would seem generally to be the practical source for the purpose; except in an unusual instance the party will have minimized

[1] 227 N. C. 561, 42 S. E. 2d 905 (1947).

[2] In this case the plaintiff's income tax return showed that he had reported therein his income for the period at an even lower figure than he claimed in his testimony. He objected that the effect of the introduction was to discredit him in the eyes of the jury as criminally evading the Federal Income Tax Laws. The court held it competent for the purpose of contradiction of his testimony "since it is a plain contradiction as to his testimony about his income."

[3] Stone v. Guion, 222 N. C. 548, 23 S. E. 2d 907 (1943); McDonald v. Carson, 95 N. C. 377 (1886); Curlee v. Smith, 91 N. C. 172 (1884); Tredwell v. Graham, 88 N. C. 208 (1883); STANSBURY, NORTH CAROLINA LAW OF EVIDENCE §167 (1946); see also, Kauffman v. Meyberg, 140 P. 2d 210 (Cal. 1943) (income tax return admitted to contradict party's testimony concerning the items reported therein).

[4] WIGMORE, EVIDENCE §1078 (3rd ed. 1940); STANSBURY, *op. cit. supra,* note 3, §§156, 168, 169.

[5] Star Manufacturing Co. v. R. R., 222 N. C. 330, 23 S. E. 2d 32 (1942); Daniels v. Fowler, 123 N. C. 35, 31 S. E. 598 (1898).

[6] See note 4 *supra.*

[7] Cheek v. Lumber Co., 134 N. C. 225, 46 S. E. 488, 47 S. E. 400 (1904); Eason v. Sutton, 20 N. C. 622 (1839); STANSBURY, *op. cit. supra,* note 3, §167.

his income in reporting it for tax purposes, at least to the extent legally possible. Or when seeking to show that an opponent's income is greater than claimed in his testimony, even if his income tax return shows an income less than testified to, it might be advantageous to introduce it for the purpose of contradicting him, and at the same time to discredit him in the eyes of the jury as having evaded the income tax laws. Under authority of the principal case[8] this purpose is not objectionable so long as it does contradict the party's testimony.[9]

The simplicity of introduction of the one document and the practical certainty that income will be at the lowest possible figure, or expenses at the highest, are the obvious advantages in the use of an opponent's income tax return over the use of his books of account. And in the case of a party who maintains no accounting records, his income tax return is of primary importance as admissions of the items contained therein.

There would seem to be no particular difficulty in obtaining a copy of a party's income tax return through the process of a subpoena *duces tecum*;[10] and the return would probably be admissible even though wrongfully obtained,[11] though such a practice is not here advocated. Also there may be a possibility of obtaining a certified copy of the party's state income tax return from the office of the state commissioner of revenue,[12] though it seems impossible to obtain in this manner a copy of his federal income tax return.[13]

Where a party wishes to introduce his own income tax return in evidence, he may introduce it to corroborate his testimony as to his income, or other matter reported;[14] and, in North Carolina at least, it would not be error if it were admitted even before the party testified.[15] Also he may use the tax return to "refresh his recollection" as to the matter reported there;[16] or he may introduce the tax return as "recorded

[8] Davis v. Atlantic Coast Line Co., 227 N. C. 561, 42 S. E. 2d 905 (1947).

[9] *Id.* at 566, 42 S. E. 2d at 909. However, when introduced for such a purpose it seems open to the objection that its *only* effect is to excite prejudice. See STANSBURY, *op. cit. supra*, note 3, §80.

[10] N. C. GEN. STAT. (1943) §8-89; N. C. GEN. STAT. (1943) §8-90; FED. R. CIV. P., 34.

[11] *Cf.* Stevison v. Earnest, 80 Ill. 513 (1875); Hernandez v. Brookdale Mills, 201 App. Div. 324 (1922); WIGMORE, EVIDENCE §2183; the only cases found in the North Carolina Digest were criminal cases which are adequately reviewed in State v. Joe McGee, 214 N. C. 184, 198 S. E. 616 (1938); see also STANSBURY, *op. cit. supra*, note 3, §121. Surely if evidence wrongfully obtained is competent in criminal cases, there can be no doubt of its competency in civil cases.

[12] N. C. GEN. STAT. (1943) §8-61; a liberal construction of the statute would be necessary, and it seems at least doubtful that such a construction would be given; see also, N. C. GEN. STAT. (1943) §105-259.

[13] 26 U. S. C. A. §55.

[14] See STANSBURY, *op. cit. supra*, note 3, §51.

[15] State v. Sutton, 225 N. C. 332, 34 S. E. 2d 195 (1945); State v. Freeman, 100 N. C. 429, 5 S. E. 921 (1888); State v. Twitty, 9 N. C. 449 (1823).

[16] STANSBURY, *op. cit. supra*, note 3, §32, and cases there cited.

past recollection" of the matter reported there when he is unable to recall to mind the information sought to be elicited.[17]

Should it become desirable for a party to introduce his own income tax return as substantive evidence of income, expenses, profit, loss, or any other matter contained therein, it may be possible to introduce it as secondary evidence of the contents of the party's "business records."[18] In such case the burden would be upon the proponent to satisfactorily account for his failure to produce his books of account themselves.[19] For example, this requirement might be satisfied by showing that the regular business records have been lost or destroyed;[20] or maybe by showing that the regular business records are so voluminous as to be impractical to bring into court or present to the jury;[21] or maybe by showing that a bringing of the records themselves into court would seriously delay and hamper the operation of the business.[22] Any of these seem to be sound and practical reasons for non-production of the original records, and adequate grounds for admitting the secondary evidence. Particularly would this seem true when viewed in light of the fact that the income tax return is made out as much as a matter of regular business as the ledgers themselves—it is, theoretically at least, an accurate summary of the business records. However, in the case of a small business, where the tax return has been prepared by the proponent himself, the opposing party might successfully object to its introduction on the ground that it may not properly reflect the contents of the original records because of the incentive to minimize income and maximize expense when reporting for tax purposes. But this objection would not be forceful in the case of a large business concern where the return is generally made up by a disinterested third person whose only incentive is to be accurate.

In the case of a party who maintains no accounting records, in the light of the modern view as to admissibility of entries made in the

[17] See discussion in STANSBURY, *op. cit. supra,* note 3, §33.

[18] For discussion of "entries in regular course of business" as an exception to the rule against hearsay, see WIGMORE, EVIDENCE §1517 *et seq.* (3rd ed. 1940); STANSBURY, *op. cit. supra,* note 3, §155.

[19] Mahoney-Jones Co. v. Osborne, 189 N. C. 445, 127 S. E. 533 (1925); see STANSBURY, *op. cit. supra,* note 3, §§190-194 for discussion of "best evidence rule."

[20] *Cf.* American Potato Co. v. Jennette Bros Co., 174 N. C. 236, 93 S. E. 795 (1917); Smith v. R. R., 68 N. C. 107 (1873); Gathings v. Williams, 27 N. C. 487 (1845).

[21] In J. A. Laporte Corp. v. Pennsylvania-Dixie Cement Corp., 164 Md. 642, 165 Atl. 195, 168 Atl. 844 (1933), it was intimated that compilations from ponderous books, even where expressly made up for purposes of the trial, were admissible without the originals, defendant's protection being "by resort to a previous examination of the final book entries, or by an account from them."

[22] *Cf.* Washington Horse Exch. v. Wilson, 152 N. C. 21, 67 S. E. 35 (1910) (witness who had examined the voluminous records was permitted to testify as to the results without bringing the records into court). It seems that a summary by way of an income tax return, prepared after examination of the business records, would be equally as competent to show the contents.

regular course of business,[23] the possibility of allowance of his income tax return into evidence as an "entry in the regular course of business" seems at least worthy of mention. The fact that the tax return is required by law should not detract from its quality of having been prepared in the regular course of business; but in point of time, the business transactions are in such case possibly recorded too late to qualify as having been made in the regular course of business[24]—the income tax return records transactions as much as a year after their occurrence.

There is the possibility of an objection against a party seeking to introduce his own income tax return as substantive evidence on the grounds that it is "self-serving."[25] This would not be a valid objection, however, *if* it has been qualified under some one of the exceptions to the rule against hearsay; because, unless the evidence is inadmissible under some hearsay rule, the fact that it is self-serving is not an independent ground for objection.[26]

Suppose that it became necessary or desirable to introduce the income tax return of a third party, would it be admissible when relevant? To avoid exclusion under the rule against hearsay, the requirements of a declaration against interest (or admission by a predecessor in title, discussed *infra*) must be met; i.e., the declarant must be dead, or for some adequate reason be unavailable as a witness;[27] the fact stated must have been against the declarant's interest at the time of the declaration, and he must have been conscious at the time that it was against his interest.[28] It would seem logically to follow that any taxable item set forth in an income tax return would be a declaration against interest because the declarant would thereby be rendered liable for the tax;[29]

[23] 28 U. S. C. A. §695; MODEL CODE OF EVIDENCE, Rule 514 (1942); STANSBURY, *op. cit. supra*, note 3, §155.

[24] One of the common law requirements for admissibility of business records is that they should have been made at or near the time of the transaction. WIGMORE, EVIDENCE §1526. This requirement is also incorporated into the code of evidence as adopted by the American Law Institute (see MODEL CODE OF EVIDENCE, Rule 514 [1942]), and into the federal Business Records Act (28 U. S. C. A. §695).

[25] Farmer v. Associated Professors of Loyola College, 166 Md. 455, 171 Atl. 361 (1934) (in suit to set aside alleged gifts of bonds, donor's income tax return held to be a self-serving declaration, and not admissible to prove donor's belief that she still owned the bonds; qualification as entry in regular course of business not argued); Clay v. Richardson, 38 S. W. 2d 849 (Texas 1931) (intimated that plaintiff might not be allowed to introduce income tax return to show loss of income over objection that it was self-serving; but here primary question was failure of plaintiff to account satisfactorily for failure to produce his books).

[26] STANSBURY, *op. cit. supra*, note 3, §140.

[27] Currin v. Currin, 219 N. C. 815, 15 S. E. 2d 279 (1941); Roe v. Journegan, 175 N. C. 261, 95 S. E. 495 (1918); Jones v. Henry, 84 N. C. 320 (1881); Woodhouse v. Simmons, 73 N. C. 30 (1875).

[28] Roe v. Journegan, 175 N. C. 261, 95 S. E. 495 (1918); STANSBURY, *op. cit. supra*, note 3, §147.

[29] *But see, In re* Stratman's Estate, 231 Iowa 480, 1 N. W. 2d 636 (1942) (complainants own assessment rolls showing money due from defendant held not

and conversely, any item of expense or loss would not be against interest, because the declarant's liability for taxes would thereby be lessened. But such a general conclusion might be upset when applied to the specific case.[30] Suppose, for example, *A* purchased from *B* a thriving resort hotel, and shortly thereafter *B* dies. In the meantime *C* has started operating a rock quarry on the lot adjoining the hotel, and not caring to mix the noise from the quarry with their afternon tea, practically all of *A*'s clientele have abandoned him. *A* brings action against *C* for damages, and desiring to show his loss of income he offered *B*'s income tax returns for the past several years. Are they admissible as declarations against interest? It could be argued that since *B* had been rendered liable for taxes by reporting his income in large amounts, that it was a declaration against his interest. Could it not also be argued that the large incomes reported enhanced the value of the property in the eyes of *A* and enabled *B* to ask a higher price in the sale to *A*, so that it was not against *B*'s interest? The sounder argument would seem in favor of a declaration against interest, because it is extremely unlikely that *A* relied on the income tax returns of *B* in arriving at his decision as to what he would pay for the property; he would, rather, depend on his inspection of the condition of the building and premises, and the average number of patrons.

Suppose in the same fact set up, blasting from *C*'s quarry had so weakened the foundations of the hotel that the walls collapsed, and in *A*'s suit for damages, *C* seeks to introduce *B*'s income tax return to show the actual value of the building after depreciation over the period of *B*'s ownership. Is it admissible as a declaration against interest? It could be argued that it is against interest, because by depreciating the building *B* thus admitted its lowered value. But it could also be argued that it is not against interest, because by so depreciating the building *B* was able to introduce the depreciation expense against his income and thus reduce liability for income tax. The sounder argument here would seem to be in favor of holding it not against interest, because the depreciated value of a building is seldom the basis upon which a purchaser makes his offer. The offer would be based upon the actual physical condition, so that *B* would not be declaring against his interest to report the building at its depreciated value.

to be "admissions against interest" merely because they subjected complainant to liability for taxes. Note, however, that the assessment rolls were those of a living person available as a witness, and the exclusion may have been for that reason; the decision is not clear on the point. *Quaere,* shouldn't it have been introduced, as suggested heretofore, as corroborative evidence?).

[30] It might conceivably be argued that the payment of taxes is for the mutual benefit of society, and that, theoretically at least, the taxpayer will benefit from paying his taxes, and thus declarations in a tax return rendering the declarant liable for taxes could never be against his interest. However, his honor being himself a taxpayer, may entertain doubts that are difficult to dispel.

In evaluating the possibility of admissibility in each particular case, there are two important requirements which must not be overlooked; the proponent of the evidence has the burden of showing that the declaration was in fact against interest,[31] and that the declarant believed it to be against his interest;[32] both are necessary because, for example, should the interest of the declarant be erroneously supposed by him to be served by the statement which he is making, the latter is devoid of probative force, although as the situation actually exists it is very much against his pecuniary or proprietary interest.[33]

In some rare case the income tax return of a third person *(B)* might also be advantageously introduced against that third person's successor in interest *(A)* as a "vicarious admission."[34] The prerequisite for the introduction of such evidence is a showing of privity between *A* and *B* as successive holders of a title,[35] that *B* made the statement while he was holder of the title, and that it could have been used against *B* in litigation over his title.[36] Contrary to the requirements of a "declaration against interest," here there is no need of a showing that the declarant is dead, or that the declaration was against interest;[37] however, such an admission is competent only *against* the successor in interest, and not in his favor.[38]

Civil cases involving the use of income tax returns as evidence seem to be extremely limited in number, but with the requirement of tax returns from practically everyone in the United States today, their statements of their financial positions are thus opened to the possibility of scrutiny; and it is not improbable that income tax returns will come into use as evidence more and more.

WALTER E. BROCK, JR.

Insurance—Fraud and Materiality of Representations—Statutory Construction

The recent case of *Carroll v. Carolina Casualty Ins. Co.*[1] serves to illustrate the relatively confused interpretations that are found to exist with respect to the short but sweeping North Carolina insurance statute[2]

[31] See note 28 *supra.*
[32] See note 28 *supra.*
[33] Roe v. Journegan, 175 N. C. 261 at 265, 95 S. E. 495 (1918) (quoting with approval from 2 CHAMBERLAYNE ON EVIDENCE §2782 [1913]).
[34] For discussion of "admissions by predecessors in interest," see STANSBURY, *op. cit. supra,* note 3, §174.
[35] Satterwhite v. Hicks, 44 N. C. 105 (1852); Guy v. Hall, 7 N. C. 150 (1819).
[36] WIGMORE, EVIDENCE §1081 (3rd ed. 1940); STANSBURY, *op. cit. supra,* note 3, §174, and cases there cited.
[37] STANSBURY, *op. cit. supra,* note 3, §174.
[38] Roberts v. Roberts, 82 N. C. 29 (1880).

[1] 227 N. C. 456, 42 S. E. 2d 607 (1947).
[2] N. C. GEN. STAT. (1943) §58-30.